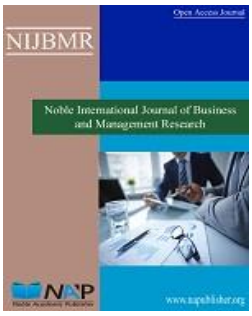
Noble International Journal of Business and Management Research
ISSN(e): 2520-4521 ISSN(p): 2522-6606
Vol. 02, No. 10, pp: 84-89, 2018



Published by Noble Academic Publisher
URL: http://napublisher.org/?ic=journals&id=2

Open Access

Credit Risk Management Practices at the Branch Level of a Rural Bank

Charles Adusei
Department of Accounting and Finance, Faculty of Business Studies,
Garden City University College, Kumasi, Ghana

Abstract: Businesses demand credit that will be used to reinvest in their business and for which they expect to earn a return. At the same time lenders supply credit to earn a return when these companies borrow. This process of extending credit has a multiplier effect on the money supply so this is why credit is a powerful driver of any economy. The aim of the study was to examine credit risk management practices of Asante Akyem Rural Bank. The data collection was gathered through questionnaires while the bank and the staff were selected purposively. Descriptive statistics and Kendall's Coefficient of Concordance were used to analyze the data. The result indicates the availability of credit policy, financial analysis of the borrower and poor management skills of clients affected effective credit risk management. The paper suggests that the management of the bank must review their credit policies from time to time to reflect the changing business environment.

Keywords: Credit Risk Management, Rural Banking, Branch Level, Quantitative Design.

1. Introduction

Credit risk is a critical risk area in the banking business which has to be managed effectively as it can cause non-performing loans or bad debts, reduces a bank's profit margins, possibility of eroding capital and in extreme cases may lead to bank failure. Financial institutions succeed as long as the risks they assume are prudent and within defined parameters of portfolio objectives. Wambui and Wanjuri (2016), considered credit as a future receipt to the lender and as a future obligation to the borrower. Rufai (2013), credit can be explained as making or offering some advances under specified repayment terms by a bank or financial institution to its customers with the belief that such loan shall be repaid as agreed. Glantz and Mun (2011) stressed that policies and procedures should be in place to ensure that exposures are properly identified, monitored, controlled and safeguards against nonperforming loans.

Kessey (2015) expressed risk as the probability of an occurrence of a loss of an actual return than an expected return. Kolapo *et. al.*, (2012) indicated that financial institutions are established to accept deposits in addition to granting of loans to their clients which makes them open to credit risk. According to Rufai (2013) credit risk is a huge problem to most banks and financial institutions and posited that credit risk can instantly provoke the failure of these establishments. Fight (2004), credit risk is defined as the possibility that a bank borrower will fail to meet its obligations in accordance with the agreed terms. Peterson *et. al.*, (2008) asserted that the general fact that risks are unavoidable in any investment of any sort is well accepted. They however noted that the question left to be tackled is the determination of trade-off point for risk and return. Van Gestel and Baesens (2009) explained credit risk management as a process that involves the identification of potential risks, the measurement of these risks, the appropriate treatment, and the actual implementations of risk models.

Rufai (2013) analyzed how bank characteristics and the overall banking environment affect bank performance. Results suggest that macroeconomic and regulatory conditions have a very great impact on bank performance. According to Kessey (2015), the main aim of credit management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Arora and Singh (2014) asserted that managing credit risk thus remains an essential and challenging corporate function. The chief goal of an effective credit risk management policy must be to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable limits. Colquitt

(2007) advised that banks need to manage credit risk in the entire portfolio as well as the risk in individual credits or transactions. Fight (2004) indicated that lending has always been the primary function of banking, and accurately assessing a borrower's creditworthiness has always been the only method of lending successfully.

Glantz and Mun (2011) insisted that credit asset quality problem is one of the obstacles limiting the development of commercial banks. Gama and Geraldes (2012) opined that banks should consider qualitative variables when setting internal systems and procedures to manage credit risk. Credit departments of banks need to be highly informed of business environment, accounting tactics of their customers and regulatory requirements as advised by Arora and Singh (2014). Al-Tamimi and Al-Mazrooei (2007) indicated that proper risk monitoring will help the bank management to discover mistakes early. Njanike (2009) highlighted obstacles in credit risk management systems by banks as lack of resources, disintegration of systems across departments, inconsistencies in risk-rating approaches, data management and stringent regulatory requirements. Adusei (2018) stressed that an efficient financial intermediation requires a stable banking system to channel surplus funds into savings for investments to promote rapid economic growth. Addai and Chengyi (2015) investigated the impact of delinquent loans on financial performance of banks in Ghana and recommended that banks must embark on effective and regular monitoring of the lending process. The paper adds to the scare empirical studies on credit risk management at the branch level of a rural bank in Ghana. The rest of the paper is organised as follows. The next section describes the methodology of the study, while the third section considers the results and discussion of the study and the final section concludes with recommendation.

2. Methodology

The study made used of quantitative design. A single case study strategy was adopted by the study via a survey. The study was conducted among managers and staff of Asante Akyem Rural Bank at the branch level as the population of the study. Within the context of this study, sample size of twenty-three (23) was generated from the population of the study. The study employed non-probability sampling method that is purposive sampling method in selecting the twenty-three (23) respondents from the chosen branch of Asante Akyem Rural Bank. In this study, the sampling criterion was that the respondents must be credit management staff of the branch, Head of department(s), Accountants or Branch Manager. For the purpose of this research interviewer administered questionnaires were used to collect the data. Data was collected mainly from the management team and the staff from the branch using five likert-scale as measurement. Descriptive statistics such as frequency tables mean and percentages were employed to analyse data used to present the socio –economic characteristics of respondents. Kendall's coefficient of concordance *(W)* analysis was used to rank the items identified on the credit appraisal practices, factors influencing credit risk management practices and challenges of effective credit management practices of the branch. The ethical considerations were adhered to in terms of getting the consent of the staff and their participation of the study was voluntary.

Reliability refers to the extent to which a scale produces consistent results if the measurements are repeated a number of times. The questionnaire had four sections with almost eighty percent of the questionnaire employed for the study was a five-likert scale. Factors influencing credit risk management practices had seven items with Cronbach Alpha of .992 and that of credit appraisal practices had eight items with Cronbach Alpha of .989 and lastly on challenges of effective credit management practices having nine items with Cronbach Alpha of .993. Reliability analysis as indicated by Kimberlin and Winterstein (2008) is the determination of obtaining the proportion of systematic variation in a scale, which can be done by determining the association between the scores obtained from different administrations of the scale. Thus, if the association in the reliability analysis is high, the scale yields consistent results and is therefore reliable. All values are within the acceptable range and greater than the cut-off point of 0.70 suggested by many researchers. This shows the reliability of the scale for internal consistency of this study.

3. Results and Discussion

3.1. Demographic Information of Respondents

Among the twenty-three (23) respondents studied, (63%) were males and (37%) were females. 50% of the respondents had worked in the banking industry for 5 to 10 years and 12% of the respondents have worked for more than ten years in the banking industry, In addition 38% of the respondents have worked in the banking industry for less than 5 years. This suggests that the respondents have the relevant experience and knowledge about the credit risk management practices in the banking industry.

It was revealed that (50%) of the sampled population has acquired educational level to the Diploma level which makes them literate to be useful at the operational level so far as banking is concern. The composition of those having qualification at the tertiary level was 25% respectively each at the undergraduate and postgraduate level. This is in line considering the nature of the banking business which needs certain specialization and competencies to run the bank effectively at the managerial level. It was refreshing to find out that 75% of the sampled population had professional qualifications prominently among them was Chartered Institute of Accountants Ghana (ICAG).

3.2. Credit Appraisal Practices

The credit appraisal practices in the (a) part of Table 1 considered eight items. A mean rating of 3.87 suggests that majority of the respondents agreed that Asante Akyem Rural Bank have competent staff for the appraisal of loan applicants. It was revealed that the appraisal of the character of a loan applicant prior to granting credit facility was not popular as evidenced with a mean of 3.13 which was the least ranked item among the eight items. It was evident that the bank request collateral as part of its appraisal practices depending on the type of credit facility demanded by a customer. The result indicated the appraisal of character and capacity of a loan applicant with a mean rating of 3.30 and 3.22 respectively. A mean rating of 3.78 confirms the availability of credit policy for the bank's operations. This result is not surprising because the Bank of Ghana (BoG) makes it compulsory for every financial institution to have credit, accounting and human resource policies to guide their operations. A mean rating of 3.57 suggest that there was credit approval limit for each staff and that loan applications were reviewed by more than one person.

Table 1. Credit Management Practices

(a)	**(b)**	**(c)**
	Mean	**Ranking**
a. Credit Appraisal Practices (*W*) = 0.388		
Competent staff for client appraisal	3.87	1st
Appraisal of client character	3.13	6th
Appraisal of clients collateral	3.30	4th
Appraisal of client capacity	3.30	4th
Appraisal of client total capital	3.22	5th
Availability of credit policy	3.78	2nd
Credit limit approval for officers	3.57	3rd
Loan applications are doubled reviewed	3.57	3rd
b. Factors influencing credit risk management practices (*W*) = 0.235		
Type of loan	3.57	4th
Type of company	3.78	1st
Credit history of client	3.65	3rd
Analysis of the market/industry	3.30	7th
Cash and projected cash flow analysis	3.52	5th
Financial analysis of the borrower	3.70	2nd
Collateral analysis of the borrower	3.48	6th
c. Challenges of effective credit management practices (*W*) = 0.640		
Insufficient skills of staff	2.53	9th
Lack of proper appraisal	2.63	8th
High interest rate	3.67	1st
Change in market condition	3.44	4th
Absence of clients credit information	3.52	3rd
Poor management skills of client	3.60	2nd
Clients poor record keeping practices	3.29	5th
Bank of Ghana policies	2.95	6th
Poor credit policy	2.77	7th

Source: Author's computation, 2018

The result from the credit appraisal practices had Kendall's coefficient of concordance (*W*) of 0.388 meaning that 38.8% of the respondents agreed to the ranking, this implies that the ranking does not cuts across among the staffs of the bank. The significance of the result reveals the importance of staff in terms of their competencies to appraise the loan application thoroughly to detect possibly gaps in the application and secondly the religious compliance of the credit policy of the bank by its staff. The result aligns with Arora and Singh (2014) indicating the need for banks and that matter credit departments to be highly informed of the business environment and the accounting tactics of their customers. On the other hand, the result further supports Kessey (2015) stressing that banks must maintain credit risk exposures within acceptable parameters. This stage is critical since effective lending underpin a sound credit granting process. This process is designed to improve monitoring and credit administration controls as well as to enhance the credit granting practices.

3.3. Factors Influencing Credit Management Strategies

Factors influencing credit management strategies of the bank considered seven items in the (b) part of Table 1. A mean rating of 3.57 indicates that majority of the respondents agreed that the type of loans they offered to their clients affected their credit risk management strategies and practices. This result is plausible because the bank has different type of loans offered to different target clients. Thus, each loan had its own management strategies. A mean of 3.65 shows that the type of companies the bank dealt with had influence on their debt and credit management strategies. This result is also understandable because some companies are more prone to failure than others. As a result, these companies required different credit management strategies. The result further showed that the credit history of their clients did affect the credit management strategies of the bank with a mean rating of 3.65. Then again, this result is not different from practice as credit history of clients is a major factor that influence the strategies employed for such clients. In this case, honest and reliable clients would obviously need to satisfy less loan requirements than perceive dishonest clients.

A mean rating of 3.70 suggests that the analysis of the financial statements of the prospective borrowers influenced the credit management practices of Asante Akyem Rural Bank. This is the basis on the projected cash flow with a mean rating of 3.52. These results were not surprised since cash flow and financial records are major determinant on a clients' ability to pay his/her loans. It is required of all loan applicants, especially 'first timers' to present their projected cash flows and financial records. These projected cash flows and financial records are mostly subjected to analysis by the staff of the Asante Akyem Rural Bank to determine their ability to repay the loans applied for.

The coefficient of concordance (W) = 0.235 or 23.5% is an indication that there is higher level of disagreement between the staffs of Asante Akyem Rural Bank on the factors influencing credit risk management practices. This can be inferred as partial consideration on the issues on credit risk management determinants. The type of company and the financial analysis of the borrower were two major considerations in influencing the credit risk management practices of Asante Akyem Rural Bank. The result supports the submissions by several authors such as Kessey (2015), Kolapo *et. al.*, (2012), Rufai (2013), Peterson *et. al.*, (2008), van Gestel and Baesens (2009). A company-specific financial performance evaluation will be key to identify the borrower's hierarchy of risks by asking key credit questions. In practice the range of ratios that can be evaluated can vary according to the lender, but usually encompasses profitability, performance, efficiency, leverage and cash flow analysis. Cash flows are important to understanding how the borrower will support future debt payments. It is imperative to take a look at the industry where the company falls in as this will help in the evaluation of the industry life cycle in which it operates.

3.4. Challenges that Affect Credit Management Practices

Challenges that affect credit management practices considered nine items in the (c) part of Table 1. The respondents were first asked whether their bank had insufficient skills of staff to manage their credit activities. The mean rating for this response item was 2.53, clearly suggesting that majority of the respondents disagreed that the bank had insufficient skills of staff to manage their credit activities. This is evidenced as it is ranked 9th and the very least of the challenges. A mean rating of 2.63 clearly shows that majority of the respondents disagreed that there is absence of proper credit appraisal in the bank as this was 8th ranked item.

A mean rating of 3.67 shows that majority of the respondents agreed that high interest rates was a challenge to their credit risk management; this was ranked 1st. As a result of unreliable credit data and high default rates in Ghana, the interest rates charged by the rural banks were relatively high. This is one of the causes of non-repayment of the loans by customers as it burdens them. A mean rating of 3.60 suggest that majority of the respondents agreed that the poor management skills of some of the clients of the bank was a major challenge to the effective management of the credit risk which was ranked 2nd. The mean rating for this response item was 3.29, indicating that most of the respondents agreed that the poor record keeping system of some of the clients of the bank was a challenge to the effective management of the credit risk of the bank. This is because the ability to pay the credit facility by clients are fairly assessed based on their incomes, thus an absent of records on incomes hinders effective administration and management of credit risk. This was ranked 5th.

The F-test for concordance (*W*) between the rankings of the factors on the challenges that affect credit risk management practices is 0.64 or 64% is fairly high and acceptable to conclude that there is a higher degree of agreement by the staffs of the bank. The results from the respondents skewed towards the customers end but a true challenge must be holistic to capture both internal and external factors. The result come short of the submission of Njanike (2009) highlighting obstacles in credit risk management systems by banks as lack of resources, disintegration of systems across departments, inconsistencies in risk-rating approaches, data management and stringent regulatory requirements. The result will further benefit from the assertion of Adusei (2018) stressing the need for an efficient financial intermediation as a requirement to a stable banking system to channel surplus funds into savings for investments to promote rapid economic growth. The result supports Glantz and Mun (2011) in a sense that credit asset quality problem is one of the obstacles limiting the development of commercial banks. Rufai (2013) suggested that macroeconomic and regulatory conditions have a very great impact on bank performance.

4. Conclusion

Credit risk measurement is an integral part of the management of credit risk exposure. The economics of credit is based on pricing transactions to realise risk adjusted returns. The aim of the study was to investigate the credit risk management practices at the branch level of a Rural Bank. The study has provided empirical evidence on how a branch of a Rural Bank deals with its credit risk management activities. The result from the study shows that there is emphasis on the caliber of the credit officer's insight and competencies coupled with robust systems and procedures of the credit department will go a long way to enhance a positive lending activity to achieve its intended objectives. However, in terms of credit risk management practices the type of company and its attributes influenced the process where consideration into the analysis of the market/industry was not a top priority to influence the credit risk management processes. High interest rate was a major challenge to borrowers while lack of proper appraisal was not an issue from the lender's point of view. It can be concluded that credit risk management practices of Asante Akyem Rural Bank were relatively effective. The paper suggests that the management of the bank must review their credit policies from time to time to reflect the changing business environment. The need for a system to be put in place for the presentation of information about the risk exposure of the bank as this will help to regularly monitor their loan portfolios. Moreover, there is the need for regular training on effective credit management practices for the staff of the bank. This will make them effective with regards to credit management and consequently reduce portfolio at risk.

Reference

Addai, B. and Chengyi, P., (2015). The Impact of Delinquent Loans on Financial Performance of Banks in Ghana, *British Journal of Economics, Management & Trade, 9(2):* 1-8.

Adusei, C. (2018). Determinants of Non-Performing Loans in the Banking Sector of Ghana between 1998 and 2013. *Asian Development Policy Review. 6(3),* 142-154.

Al-Tamimi, H. A. H. and Al-Mazrooei, F. M. (2007). Banks risk management-A comparison study of UAE national and foreign banks. *Journal of Risk Finance 8(4),* 394-409.

Arora, R. and Singh, A. (2014). Problems and Obstacles in Credit Risk Management in Indian Public Sector Banks. *Annals of the University of Petrosani, Economics. 14(1)* 353-362.

Colquitt, J. (2007). *Credit Risk Management: How to avoid lending disasters and maximize earnings* 3rd Edition. McGraw-Hill. New York.

Fight, A. (2004). *Credit Risk Management.* Elsevier Butterworth-Heinemann. Burlington.

Gama, A. P. M. and Geraldes, H.S.A. (2012). Credit risk assessment and the impact of the New Basel Capital Accord on small and medium-sized enterprises – An empirical analysis. *Management Research Review. 35(8* 727-749.

Glantz, M. and Mun, J. (2011). *Credit Engineering for Bankers: A Practical Guide for Bank Lending.* 2nd Edition. Academic Press. Burlington.

Kessey, K. D. (2015). Assessing Credit Risk Management Practices in the Banking Industry of Ghana: Processes and Challenges. *Global Journal of Management and Business Research, 15(6)* 1-11.

Kimberlin, C. l. and Winsterstein, A.G., (2008). Validity and Reliability of Measurement Instruments used in research. *American Journal of Health-System Pharmacy,* 65(23) 2276-2284.

Kolapo, T.F., Ayeni, R. K. and Oke, M. O. (2012). Credit Risk and Commercial Banks Performance in Nigeria: A Panel Approach. *Australian journal of Business and Management Research*, *2(2) 31-38.*

Njanike, K. (2009). The Impact of Effective Credit Risk Management on Bank Survival. *Annals of the University of Petrosani, Economics. 9(2)* 173-184.

Peterson, C., Richard, E., Chijoriga, M., Kaijage, E., and Bohman, H. (2008). Credit Risk Management System of a Commercial Bank in Tanzania. *International Journal of Emerging Markets,* 3(3) 323-332.

Rufai, A. S. (2013). Efficacy of Credit Risk Management on the Performance of Banks in Nigeria A Study of Union Bank PLC (2006-2010). *Global Journal of Management and Business Research Administration and Management,* 13(4) 1-12.

Van Gestel, T. and Baesens, B. (2009). *Credit Risk Management Basic Concepts: Financial risk components, rating analysis, models, economic and regulatory capital*. Oxford University Press. Oxford.

Wambui, M. C. and Wanjiru, M. M. (2016). The Effect of Credit Risk on Corporate Liquidity of Deposit Taking Microfinance Institutions. *International Journal of Business and Social Science, 7(4)* 181-189.